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No. 88-249

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

STITT SPARK PLUG COMPANY,

Petitioner,

v.

CHAMPION SPARK PLUG COMPANY,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

RUFUS W. OLIVER, III*
N. K. ALEXANDER, JR.
BAKER & BOTTS
One Shell Plaza
Houston, Texas 77002
713/229-1234

DONALD F. MELHORN, JR.
MARSHALL & MELHORN
Four Seagate, Eighth Floor
Toledo, Ohio 43604
419/249-7100

Counsel for Respondent

**Counsel of Record*

1988

RESTATEMENT OF QUESTIONS PRESENTED

1. May a claim of predatory pricing be established without proof that defendant has foregone profit as a means of eliminating competition?

2. Can a manufacturer be found to have engaged in unlawful exclusive dealing, without proof (1) that customers honored alleged agreements not to deal in competitors' merchandise, (2) that any customer agreed to refrain from selling competing merchandise for any specified period of time, or (3) that any customer who failed to abide by the alleged agreement would be subject to any sanction?

STATEMENT REQUIRED BY SUPREME COURT RULE 28.1

Respondent Champion Spark Plug Company has no parent companies, subsidiaries (except wholly-owned subsidiaries), or affiliates.

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OPINION BELOW

The opinion of the Court of Appeals is reported at 840 F.2d 1253 (5th Cir. 1988).

RESTATEMENT OF THE CASE

In this private antitrust suit petitioner Stitt Spark Plug Company charged respondent Champion Spark Plug Company with predatory pricing, price discrimination, and unlawful exclusive dealing. After Stitt rested its case in chief, the trial court granted Champion's motion for directed verdict. A panel of the United States Court of Appeals for the Fifth Circuit unanimously affirmed.

Champion and Stitt are competing manufacturers of spark plugs. Champion makes a full line of spark plug "models," known in the industry as "types," for all kinds of engines.

Stitt specializes in spark plugs for stationary engines used principally in the oil and gas industry. The term "industrial spark plugs" is sometimes used to refer to the specially designed, relatively low-volume, relatively high-priced spark plugs of the kind Stitt manufactures, although in this case Stitt gave the term a much broader meaning, extending even to Champion conventional automotive plugs. *See* Trial Court's Findings of Fact, R. Tab 240 at 15-16[1]; *compare* PX277 [list of "industrial" spark plugs prepared by Stitt] *with* DX41 [Champion listing of applications by plug type, listing many of such plugs for use in automobiles, outboard motors, etc.].

Spark plug manufacturers sell spark plugs directly to engine and vehicle manufacturers for factory installation as "original equipment." Plug manufacturers also sell plugs to marketers known as distributors, who in turn resell them for replacement purposes. Stitt contended that, in recognition of the tendency of engine and vehicle operators to replace worn spark plugs with the same brand installed in the engine as original equipment, a phenomenon Stitt called the "OE tie," Champion charged a lower price to OE purchasers than to "replacement" purchasers.

Stitt alleged that the difference between Champion's OE and replacement prices constituted unlawful price discrimination under Clayton Act Section 2(a), 15 U.S.C. §13(a). Stitt also contended that Champion's OE prices were below Champion's "average variable cost" of manufacture, and were therefore predatory and amounted to actual or attempted monopolization in violation of Sherman Act Section 2, 15 U.S.C. § 2. In addition, Stitt charged that Champion had

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[1] Citations to the record will be by the abbreviation "R.Tab" followed by the index tab number affixed by the district court clerk to materials in the first twelve volumes, together with the stamped page number assigned by the district clerk if necessary. "DX" and "PX" refer, respectively, to defendant's and plaintiff's trial exhibits.

entered into agreements with resellers of spark plugs prohibiting them from handling the Stitt line, in violation of Sherman Act Section 1, 15 U.S.C. § 1, and Clayton Act Section 3, 15 U.S.C. § 14.

Stitt contended that the relevant market for purposes of assessing Champion's actions was sales of what it called "industrial spark plugs" and that this alleged market comprised separate OE and replacement "submarkets." The term "industrial spark plugs" was never clearly defined. There was considerable dispute over whether "industrial spark plugs," however defined, could be a relevant market and over which spark plug brands and types were relevant to the case.

Trial commenced in August 1986 before Judge Lynn N. Hughes and a jury. With regard to Stitt's charge of unlawful exclusive dealing, the Fifth Circuit summarized the evidence as follows:

> The written agreement between Champion and its distributors disclaimed any obligation for the distributor to carry only Champion products. Stitt alleges, however, that Champion secured such agreement under the guise of a promotional program known as "Feature Line Selling." Under the program, Champion analyzed the distributor's rate of inventory turnover to determine which non-Champion brands were worth carrying; the underlying principle was that a distributor could reduce inventory costs by carrying only Champion's full line of plugs. Champion supplemented this persuasion by offering distributors promotional gifts, ranging from jackets to refrigerators, if they removed competing spark plugs from their shelves. Several former Champion salespersons and supervisors testified that these incentives persuaded at least three distributors to agree to stop carrying Stitt plugs.

> . . . While Stitt proved that a handful of distributors once removed Stitt plugs from their shelves, Stitt provided no instance in which a distributor honored an exclusive dealing agreement by refusing to purchase Stitt plugs. In addition, there was no testimony that any distributor agreed to refrain from selling competing plugs for any specified period of time. There was no evidence that a distributor who failed to abide by the agreement would be subject to any sanction and hence no reason to believe distributors did not feel free to stock competing plugs. . . .

840 F.2d at 1257-8 (footnote omitted).

Stitt's proof of Champion's alleged predatory pricing consisted of testimony by Stitt's accountant, who, with respect to certain Champion spark plug types selected by Stitt or its counsel, compared Champion's selling prices with his estimate of Champion's "average variable cost" to manufacture each of those types. His analysis showed that some of the selected Champion plug types were priced below his estimate of Champion's "average variable manufacturing cost." It was undisputed, however, that the Champion plug types Stitt treated as "industrial spark plugs" were, in the aggregate, priced *above* Stitt's estimate of Champion's average variable cost of manufacturing those plug types. DX 62, 63; R.Tab 240 at 19-20.

At the close of Stitt's case, Judge Hughes granted Champion's motion for directed verdict. As he explained his ruling from the bench and in a later memorandum containing findings of fact and conclusions of law, R.Tab 240, 241, Judge Hughes was of the view that Stitt had simply failed to prove any essential element of its claims.

On appeal, a unanimous panel of the United States Court of Appeals for the Fifth Circuit affirmed, in an opinion by Judge Patrick Higginbotham. With regard to Stitt's claim of predatory pricing, Judge Higginbotham observed that, in

calculating the "price" that Champion received on a sale of its plugs, Stitt had looked only at the current revenue received on the sale and had disregarded future revenue that might be generated by virtue of the consumer's tendency to replace worn plugs with the original equipment brand. In doing so, Stitt contradicted its theory of the "OE tie," which held that Champion set its OE prices at low ("predatory") levels with the expectation of receiving higher prices on later replacement sales generated by the alleged "tie." Thus, Stitt failed to make "any meaningful comparison of cost and price." 840 F.2d at 1256.

Moreover, Judge Higginbotham pointed out that Stitt's claim of "predatory pricing" did not actually involve "predation" at all, in the sense of conduct that can benefit the predator only by eliminating competitors and thereby allowing the predator to raise prices to noncompetitive levels. Under Stitt's curious theory of "predation" Champion was incurring losses by charging low OE prices but simultaneously recouping the losses by charging higher prices on replacement sales in the face of continuing competition from Stitt and other plug manufacturers. Champion's ability to recoup its "losses" obviously did not depend on first eliminating Stitt or others from the marketplace. Thus Stitt's claim that Champion's pricing policy was aimed at eventually achieving market power was implausible. *Id.*

Judge Higginbotham turned next to Stitt's charge that Champion had unlawfully discriminated in price merely by charging a different price on OE sales than on replacement sales. Judge Higginbotham observed that under settled Fifth Circuit precedent — which Stitt does not challenge here — the crucial element of "competitive injury" in a price discrimination suit brought by a competitor of the defendant (a "primary line" case) can be established only by proof that defendant's prices were "predatory" in the same sense re-

quired under Sherman Act Section 2. Stitt's failure to prove predation, as explained above, was therefore also fatal to its price discrimination claim. *Id.* at 1257.

Finally, with respect to Stitt's exclusive dealing claim, Judge Higginbotham said that "perhaps" Stitt had introduced enough evidence to reach the jury on the existence of alleged exclusive dealing agreements; but that Stitt had failed to furnish any basis for the finding — an essential element of exclusive dealing claims under both Section 1 and Section 3 — that such agreements had foreclosed Stitt from any "substantial" part of the market. *Id.* at 1257-8.

SUMMARY OF ARGUMENT

The judgment below is correct. In failing to account for Champion's replacement sale revenue — which according to Stitt's theory of the "OE tie" would be assured by selection of the Champion brand as original equipment — Stitt accounted for only part of the "price" received by Champion. Stitt thus failed to establish the most fundamental element of a claim of "below cost" pricing: that the "price" was in fact *below* cost. Moreover, by showing that Champion was presently recouping its alleged OE losses through replacement sales, Stitt's evidence contradicted any inference that Champion's pricing strategy was intended to eliminate Stitt as a competitor. With regard to Stitt's claim of exclusive dealing, Stitt failed to show that Champion's alleged exclusive dealing agreements with customers had any market impact, much less that they foreclosed Stitt from a "substantial" portion of the relevant market. Finally, there is no substance whatever to Stitt's claim that the opinion below conflicts with prior decisions of this Court or of the Fifth Circuit.

ARGUMENT

I. THE FIFTH CIRCUIT CORRECTLY HELD THAT STITT WAS NOT ENTITLED TO REACH THE JURY ON ITS CLAIM OF PREDATORY PRICING.

A. Stitt Did Not Offer Proof that Champion's "Price" was Below its Cost.

"Predatory" pricing is "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run." *Cargill, Inc.* v. *Montfort of Colorado, Inc.*, — U.S. —, 107 S. Ct. 484, 493 (1986); *see also Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 584 n.8 (1986).[2] The most basic part of a predatory pricing case, therefore, is proof that defendant's price was below its "cost."

Stitt contended that Champion deliberately set its OE prices at low levels in the belief that it would recoup its OE "losses" by charging higher prices on the replacement sales to be generated by virtue of the "OE tie." *See, e.g.*, R. Tab 188 at ¶ 18 [Stitt's First Amended Complaint]. If this is true, it follows that Champion must, in setting its low OE price, take into account the revenue it will receive on replacement sales at the higher replacement price. "When Champion sets the prices for original-equipment plugs, the expected return includes not only the price paid by the original-equipment manufacturer, but also the replacement purchases that probably will follow." 840 F.2d at 1256. Logically, then, a charge that Champion's price was "predatory" must consider antici-

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[2] In the Fifth Circuit, the "appropriate measure of cost" in a predatory pricing case is "average variable cost." International Air Industries, Inc. v. American Excelsior Co., 417 F.2d 714 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976). The instant case presents no question concerning whether average variable cost should be used in determining defendant's costs for purposes of a predatory pricing claim.

pated replacement sales revenues in calculating the "price" Champion receives when it makes an OE sale.

When Judge Higginbotham said that it was necessary to "look at the original and replacement markets together," *id.*, he was not ignoring the alleged distinction between the supposedly "separate" OE and replacement "submarkets," or "finding" that only a "single market" existed. *See* Petition for Certiorari at 18-19. He was not treating market definition at all.[3] Rather, he was simply saying that Stitt, having alleged that Champion set its OE prices with the expectation of receiving additional revenue on replacement sales, logically should take Champion's replacement revenues into account in determining Champion's OE "price." Stitt's failure to do so precluded "any meaningful comparison of price and cost." 840 F.2d at 1256.

B. Champion's Alleged Pricing Policy Was Not "Predatory" Because Champion's Ability to Recoup Alleged "Losses" Did Not Require Elimination of Competition.

As noted above, this Court in *Cargill, supra*, explained that predatory pricing was aimed at "eliminating competitors in the short run and reducing competition in the long run." 107 S.Ct. at 493. In *Matsushita, supra*, the Court observed that predatory pricing schemes could not hope to succeed (and presumably would not be attempted by rational firms) without some assurance that competitors could be eliminated and kept out long enough to raise prices, recover losses suffered

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[3] His opinion expressly refrained from reaching the market definition question. 840 F.2d at 1258 n.19. Nor was he necessarily "extending" the holding of Bayou Bottling, Inc. v. Dr. Pepper Co., 725 F.2d 300 (5th Cir.), *cert. denied*, 469 U.S. 833 (1984), that proof of predatory pricing must consider the entire product line on which the parties compete, rather than isolated products within the line. Plainly, Judge Higginbotham cited *Bayou Bottling* merely as analogous support: his citation of the case is preceded by "*cf.*" 840 F.2d 1256 n.11.

during the campaign of predation, and earn enough additional gain to make the effort worthwhile:

> [T]he success of [predatory pricing] schemes is inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition. Moreover, it is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits. The success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain. Absent some assurance that the hoped-for monopoly will materialize, and that it can be sustained for a significant period of time, "[t]he predator must make a substantial investment with no assurance that it will pay off." Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 268 (1981). For this reason, there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful . . . .

475 U.S. at 589 (emphasis supplied).[4]

As Judge Higginbotham noted, Champion's allegedly "predatory" behavior was quite different from the conduct considered in *Matsushita* and *Cargill*. Champion's ability to "raise" prices (*i.e.*, charge the higher replacement price) did not depend on first eliminating Stitt from the market. Indeed, Champion was charging the higher replacement prices and recouping its alleged "losses" on OE sales in the face of continued competition from Stitt and numerous other spark plug manufacturers. The record showed that no fewer than six manufacturers other than Stitt and Champion sold spark plugs in the United States for applications utilizing what Stitt

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[4] Contrary to Stitt's suggestion that *Matsushita* applies only to cases charging unlawful concerted action, *see* Petition at 16-17, the *Matsushita* opinion expressly declares that the language just quoted applies "even to predatory pricing by a *single firm* seeking monopoly power." 475 U.S. at 590 (emphasis supplied).

alleged were Champion "industrial" spark plugs. *See* DX 35-38, 197 [competitors' catalogs], PX 277 [Stitt list of "industrial" spark plugs including plugs made by French firm BG]. Stitt could and did take advantage of the OE "tie" by offering low OE prices of its own, *e.g.*, DX 104, 113, 138, 141, 143 [Stitt offers to sell at 6¢ per plug.] Indeed, Stitt's witnesses testified that the OE tie would work for *any* manufacturer who succeeded in having its plugs installed at the factory. *See* 840 F.2d at 1256. Stitt failed to show that Champion's pricing strategy was anything other than a rational response to the market phenomenon described as the "OE tie."

II. THE FIFTH CIRCUIT CORRECTLY HELD THAT STITT'S FAILURE TO SHOW ANY ACTUAL MARKET FORECLOSURE WAS FATAL TO ITS EXCLUSIVE DEALING CLAIM.

Even if Champion had entered into exclusive dealing agreements with spark plug marketers, it could not be found to have violated either Sherman Act Section 1 or Clayton Act Section 3 without proof that such agreements actually prevented Stitt from selling its products to a substantial segment of the relevant market. "[T]he competition foreclosed by the contract must be found to constitute a substantial share of the relevant market. . . . [A] mere showing that the contract itself involves a substantial number of dollars is ordinarily of little consequence." *Tampa Electric Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 328-39 (1961). "Exclusive dealing is an unreasonable restraint of trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal." *Jefferson Parish Hospital Dist. No. 2* v. *Hyde*, 466 U.S. 2, 45 (1984) (concurring opinion of O'Connor, J.).

As Judge Higginbotham noted, Stitt failed to show *any* foreclosure by reason of alleged exclusive dealing contracts between Champion and its customers. There was no evidence that a single customer actually stopped buying plugs

from Stitt; no evidence that any marketer agreed to cease or reduce his purchases from Stitt for any period of time; no evidence that any customer risked sanctions for stocking or promoting Stitt plugs. Stitt's own records showed that all the Stitt customers who were identified by name as having "exclusive dealing" agreements with Champion continued buying plugs from Stitt. DX 5-10. At most, Stitt proved only that a handful of distributors, persuaded that some Stitt plugs were not sufficiently profitable to keep them in inventory, returned them to their suppliers. This is not "foreclosure," much less "substantial" foreclosure.

III. STITT'S CLAIMS OF CONFLICT WITH OTHER DECISIONS ARE WITHOUT MERIT.

Stitt's claims that the opinion below conflicts with other decisions are no more substantial than its other claims. With respect to *Ford Motor Co.* v. *United States*, 405 U.S. 565 (1972), Stitt's position is incomprehensible. Although Stitt says that *Ford* "defines *two markets* and not one market," Petition at 19 (emphasis supplied), *Ford* very plainly did *not* "define" any market (*Ford* was a vertical merger case arising from Ford's acquisition of a spark plug manufacturer; the opinion deals chiefly with the issue of appropriate remedies.) Nor, as seen earlier, did the opinion below reach the question of market definition. For the same reason, Stitt's claim of conflict with various Fifth Circuit decisions holding that market definition is a fact issue, Petition at 19, is utterly without merit: the Fifth Circuit did not "substitute" its views for those of the factfinder because it never reached the issue.

As for Stitt's claims that the opinion below conflicts with Fifth Circuit decisions establishing the elements of proof of predatory pricing (*Adjusters Replace-A-Car* v. *Agency Rent-A-Car, Inc.*, 735 F.2d 884 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985), and *International Air Industries, Inc., supra*), *see* Petition at 17, it suffices to say (putting aside the question

whether such a conflict if actually shown would warrant review by certiorari) that the Fifth Circuit simply held that Stitt did not satisfy the standards of proof established by those cases.

This applies equally to Stitt's contention that the opinion below conflicts with Fifth Circuit precedent establishing the elements of unlawful exclusive dealing, Petition at 20. *Dillon Materials Handling, Inc.* v. *Albion Industries*, 567 F.2d 1299 (5th Cir), *cert. denied*, 439 U.S. 832 (1978), the allegedly conflicting opinion, held that a terminated distributor charging unlawful exclusive dealing had to show, first, "that its purchases as a distributor . . . were made on the 'condition, agreement, or understanding' that it would not sell [competitors' products]" and, second, that such an agreement "had the requisite effect on competition." 567 F.2d at 1302. How Judge Higginbotham's opinion in the instant case "conflicts" with this is not apparent; Judge Higginbotham upheld the directed verdict on Stitt's exclusive dealing claim precisely because Stitt failed to demonstrate the "requisite effect on competition."

Stitt's failure of proof also obviates any claim of conflict with *Heatransfer Corp.* v. *Volkswagenwerk A.G.*, 553 F.2d 964 (5th Cir. 1977), *cert. denied*, 434 U.S. 1087 (1978), which, Stitt says, stands for the principle that "below cost selling alone, in a definable market, taken together with the size of the market share (99%), is probative of monopolization." Petition at 18. Without reaching the question whether that is a fair characterization of *Heatransfer*, it is enough to note that the Fifth Circuit in this case held that Stitt did not *prove* "below cost selling."

CONCLUSION

For the foregoing reasons, Champion respectfully requests that the Petition be denied.

Respectfully submitted,

September 9, 1988

RUFUS W. OLIVER, III°
N. K. ALEXANDER, JR.
3000 One Shell Plaza
Houston, Texas 77002
(713) 229-1234

Attorneys for Respondent Champion Spark Plug Company

°*Counsel of Record*

Of Counsel:

BAKER & BOTTS
Houston, Texas 77002

DONALD F. MELHORN, JR.
MARSHALL & MELHORN
Four SeaGate, Eighth Floor
Toledo, Ohio 43604

CERTIFICATE OF SERVICE

I certify that three true and correct copies of the above and foregoing Respondent's Brief in Opposition were served upon the attorney of record for petitioner, Wayne H. Paris, O'Dell, Paris & Dugger, Suite 700, 550 Westlake Park Blvd., Houston, Texas 77079, by depositing them in a United States post office, first class postage prepaid, on this 9th day of September, 1988. I further certify that all parties required to be served have been served.

RUFUS W. OLIVER, III
A Member of the Bar of this Court